

Accumulate

Sputnik V receives expert panel nod for approval

Russia's COVID vaccine Sputnik V has been recommended for use in India by the expert committee. Dr. Reddy's has partnered with RDIF (Russian Direct Investment Fund) to distribute (in India) first 250mn dosages of Sputnik V. Currently in Phase 3 in India, DCGI in Feb'21 had asked for immunogenicity data before being granted an emergency approval. Once approved, this would be the third vaccine post Covaxin (Bharat Biotech) and Covishield (SII and Oxford-Astrazeneca) in India. While the final approval is yet to be received, we believe that once approved it could contribute ~R5.9bn of earnings translating into NPV of Rs35 per share (assuming price of Rs225 per dose). We have factored in 45% of distribution and marketing benefits for Dr. Reddy's.

After a series of disappointments in the last two years (such as gCopaxone and gNuvaring), we believe expectations from Dr. Reddy's complex generic pipeline has bottomed out and upsides from launches such as gCiprodex (Aug 2020), gKuvan tab (Oct 2020), gVascepa (1HFY22), gRevlimid (FY23) & biosimilar pegfilgrastim (FY22) and filings for biosimilar rituximab (FY22) & novel biologic E7777 (1HFY22) are likely to surprise positively. While execution in markets such as India, EU & EMs and the strengthening of base business in the US are expected to continue from recent years, potential upsides from niche opportunities in the US provide additional comfort on growth in the next 2-3 years. At CMP, stock is trading at 22x FY23E EPS of Rs216 +Rs40 NPV for Sputnik V + Rs175 for gRevlimid. We maintain Accumulate with a target price of Rs5400.

About Sputnik V: Dr Reddy's has partnered with RDIF to distribute Sputnik V in India exclusive supply of 250mn doses (initially imported committed supply of 100mn doses from RDIF). Sputnik V, which uses adenovirus vectors for delivering the genetic material coded for SARS-CoV-2's Spike protein, is unique in using two different adenovirus vectors for the first and second doses of the vaccine, which in our view should generate stronger immune response (vs. other Covid-19 vaccines, which use the adenovirus vector platform – such as vaccines from Astrazeneca and J&J). The efficacy is claimed to be ~92% when two shots are given 3 weeks apart. In India, Sputnik trials are on ~1600 people.

Partnerships: RDIF has announced several manufacturing partnerships including with Hetero Labs (100mn doses), Gland Pharma, Stelis Biopharma (200mn doses), Virchow Biotech (200mn doses), Panacea Biotech (100mn doses). With this RDIF has partnered for production of 850mn doses of Sputnik V in India. For clinical trials and distribution, it has partnered with Dr. Reddy's.

FINANCIALS (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	155,806	178,890	190,424	218,482	251,321
Growth(%)	9.1	14.8	6.4	14.7	15.0
EBITDA	33,288	45,232	44,591	52,985	61,917
OPM(%)	21.4	25.3	23.4	24.3	24.6
PAT	19,259	21,733	25,629	30,205	35,953
Growth(%)	96.4	12.8	17.9	17.9	19.0
EPS(Rs.)	116.2	131.1	154.6	182.2	216.8
Growth(%)	96.4	12.8	17.9	17.9	19.0
PER(x)	43.0	38.1	32.3	27.4	23.0
ROANW(%)	14.1	13.2	11.6	16.5	17.0
ROACE(%)	11.1	21.6	15.2	16.2	16.9

CMP	Rs 4,997
Target / Upside	Rs 5,400 / 8%
NIFTY	14,311

Script Details

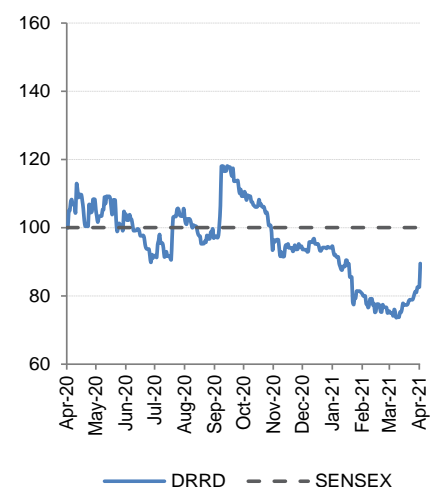
Equity / FV	Rs 831mn / Rs 5
Market Cap	Rs 828bn
	USD 11bn
52-week High/Low	Rs 5,513 / 3,607
Avg. Volume (no)	1,164,160
Bloom Code	DRRD IN

Price Performance	1M	3M	12M
Absolute (%)	13	(7)	38
Rel to NIFTY (%)	18	(4)	(16)

Shareholding Pattern

	Jun'20	Sep'20	Dec'20
Promoters	26.7	26.7	26.7
MF/Banks/FIs	35.7	36.3	35.9
FIIs	29.6	29.3	29.1
Public / Others	8.0	7.6	8.3

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Logistics and storage: RDIF has developed a lyophilized formulation of the vaccine, which can be stored at a temperature of 2-8 degree (vs the liquid formulation which requires -18 degree).

Production: The initial batches will be imported as production in India is yet to commence.

Pricing: While the financial upside is unclear as it will depend upon the pricing, current manufacturers are supplying to the government at US\$2-3 per dose.

Our assumptions for vaccine optionality: Assuming a population of 250mn currently (125mn each year in FY22 and FY23), we have assumed that at manufacturing cost of Rs150 per dose (\$2), the pricing for the vaccine could be Rs225 (\$3 per dose). Assuming a distribution margin of 70%, Dr Reddy's could retain 70% of the revenue and an EBITDA margin of 20% (lower than company's margin), translating into an NPV of Rs35 per share. We have not factored any private distribution in our assumptions and that could be incremental to our assumptions.

Exhibit 1: Sputnik V Vaccine opportunity

No. of doses (mn)	250
Price per dose (Rs)	225
Revenue (Rs mn)	56,250
Dr Reddy's revenue realization (Rs mn)	39,375
Overhead costs (Rs mn)	31,500
EBITDA	7,875
EBITDA margins	20%
Tax	1,969
PAT (Rs mn)	5,906
NPV (Rs)	35

Source: Company, DART

While the above are based on various assumptions, we await clarifications on the following:

- 1) Whenever the approval is received, will it be through government or private channel?
- 2) Is Dr Reddy's only the facilitator for the vaccine and can Indian government directly approach RDIF for vaccines?
- 3) Sputnik V requires cold storage facility. In case of government procurement, who would bear the logistics cost?
- 4) What has been Dr. Reddy's investment so far in this deal? What would the distribution margin (revenue realization) be?
- 5) It has the sole exclusivity to distribute 250mn doses, post that will the other partners be eligible for distribution?
- 6) If there is a price cap on vaccines, then is there a scope for Dr Reddy's to still make margins?

Exhibit 2: Indian COVID Vaccine candidates: Current Status

Manufacturer	Vaccine candidate	Platform	Efficacy	Annual Capacity	Stage	Remarks
Serum Institute of India	Covishield (in collaboration with AZN/Oxford)	Adenovirus vaccine vector	81.3%: 2 shots given 12 weeks apart	840mn-1.2bn	Phase III initiated	100 mn doses for India secured at INR 200 per dose, c. 40 mn doses already manufactured; company has assured of 50:50 share between India & ROW
	Novavax	Adjuvant recombinant protein based	55%: 2 shots given <6 weeks apart (Covishield)			
Bharat Biotech	Covaxin	Adenovirus vaccine vector	80.60%	150mn	Phase III initiated	Brazil has signed a deal with Bharat Biotech for the purchase of 20 mn doses; the deal is worth BRL 1.6 bn with the first 8 mn doses expected to be dispatched by the company in March
Aurobindo Pharma	Covaxx	Vesicular Stomatitis virus based	-	400mn	Phase I completed	The Subject Expert Committee of CDSCO has recommended that the company should submit the Phase II/III clinical trial protocol approved by the regulatory authority of Brazil
Biological E	J&J	Adenovirus vaccine vector	-	1bn	Phase II initiated	Targeting 600 mn doses for J&J; this is in addition to its own vaccine for which the company is targeting c.1 bn doses
	Dynavax	Adjuvant recombinant protein based				
Cadila healthcare	ZyCoV-D	DNA plasmid vaccine	-	200mn	Phase III initiated	Cadila is setting up a facility to manufacture 120 mn doses of ZyCoV-D (expected to be ready for commercial production by 1QFY22); besides, the company is looking at possible tie-ups with partners to add another 60-70 mn doses, with a target production capacity of 200 mn doses
Dr Reddy's Labs	Sputnik V (in distribution partnership with RDIF)	Adenovirus vaccine vector	91.6%: 2 shots given 3 weeks apart	250mn	Phase III initiated	Received the Subject Expert Committee approval of Sputnik V for Emergency Usage Authorization

Source: Company, DART

Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Revenue	178,890	190,424	218,482	251,321
Total Expense	133,658	145,833	165,497	189,403
COGS	71,951	79,176	91,004	104,795
Employees Cost	0	0	0	0
Other expenses	61,707	66,657	74,492	84,608
EBIDTA	45,232	44,591	52,985	61,917
Depreciation	12,472	14,060	15,088	16,893
EBIT	32,760	30,530	37,897	45,025
Interest	983	796	721	645
Other Income	3,022	2,188	2,050	2,312
Exc. / E.O. items	(16,767)	(6,751)	0	0
EBT	18,032	25,171	39,227	46,692
Tax	(1,466)	6,293	9,022	10,739
RPAT	19,498	18,878	30,205	35,953
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	21,733	25,629	30,205	35,953

Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	831	831	831	831
Minority Interest	0	0	0	0
Reserves & Surplus	154,157	168,881	194,932	226,731
Net Worth	154,988	169,712	195,763	227,562
Total Debt	17,745	16,745	14,745	12,745
Net Deferred Tax Liability	(5,279)	(6,500)	(7,844)	(9,322)
Total Capital Employed	167,454	179,957	202,664	230,985

Applications of Funds

Net Block	79,991	94,921	90,407	86,108
CWIP	3,994	4,739	4,514	4,299
Investments	5,672	5,930	6,214	6,526
Current Assets, Loans & Advances	130,370	131,516	161,466	198,169
Inventories	35,067	38,012	45,526	51,861
Receivables	50,278	48,149	52,530	59,270
Cash and Bank Balances	2,053	567	13,279	30,893
Loans and Advances	1,105	553	564	575
Other Current Assets	18,180	18,180	20,907	24,043
Less: Current Liabilities & Provisions	52,573	57,149	59,938	64,119
Payables	16,659	19,766	21,012	23,573
Other Current Liabilities	35,914	37,383	38,926	40,545
	<i>sub total</i>			
Net Current Assets	77,797	74,366	101,529	134,051
Total Assets	167,454	179,957	202,664	230,985

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	59.8	58.4	58.3	58.3
EBIDTA Margin	25.3	23.4	24.3	24.6
EBIT Margin	18.3	16.0	17.3	17.9
Tax rate	(8.1)	25.0	23.0	23.0
Net Profit Margin	10.9	9.9	13.8	14.3
(B) As Percentage of Net Sales (%)				
COGS	40.2	41.6	41.7	41.7
Employee	0.0	0.0	0.0	0.0
Other	34.5	35.0	34.1	33.7
(C) Measure of Financial Status				
Gross Debt / Equity	0.1	0.1	0.1	0.1
Interest Coverage	33.3	38.3	52.6	69.8
Inventory days	72	73	76	75
Debtors days	103	92	88	86
Average Cost of Debt	3.8	4.6	4.6	4.7
Payable days	34	38	35	34
Working Capital days	159	143	170	195
FA T/O	2.2	2.0	2.4	2.9
(D) Measures of Investment				
AEPS (Rs)	131.1	154.6	182.2	216.8
CEPS (Rs)	206.3	239.4	273.2	318.7
DPS (Rs)	25.1	25.1	25.1	25.1
Dividend Payout (%)	19.1	16.2	13.8	11.6
BVPS (Rs)	934.8	1023.6	1180.7	1372.5
RoANW (%)	13.2	11.6	16.5	17.0
RoACE (%)	21.6	15.2	16.2	16.9
RoAIC (%)	19.2	17.7	20.6	23.1
(E) Valuation Ratios				
CMP (Rs)	4997	4997	4997	4997
P/E	38.1	32.3	27.4	23.0
Mcap (Rs Mn)	828,494	828,494	828,494	828,494
Mcap/ Sales	4.6	4.4	3.8	3.3
EV	820,499	818,617	801,299	778,819
EV/Sales	4.6	4.3	3.7	3.1
EV/EBITDA	18.1	18.4	15.1	12.6
P/BV	5.3	4.9	4.2	3.6
Dividend Yield (%)	0.5	0.5	0.5	0.5
(F) Growth Rate (%)				
Revenue	14.8	6.4	14.7	15.0
EBITDA	35.9	(1.4)	18.8	16.9
EBIT	56.8	(6.8)	24.1	18.8
PBT	(19.7)	39.6	55.8	19.0
APAT	12.8	17.9	17.9	19.0
EPS	12.8	17.9	17.9	19.0

Cash Flow

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	15,924	35,256	31,454	38,405
CFI	6,024	(30,046)	(12,093)	(14,207)
CFF	(22,123)	(6,696)	(6,649)	(6,584)
FCFF	21,948	5,209	19,361	24,198
Opening Cash	2,228	2,053	567	13,279
Closing Cash	2,053	567	13,279	30,893

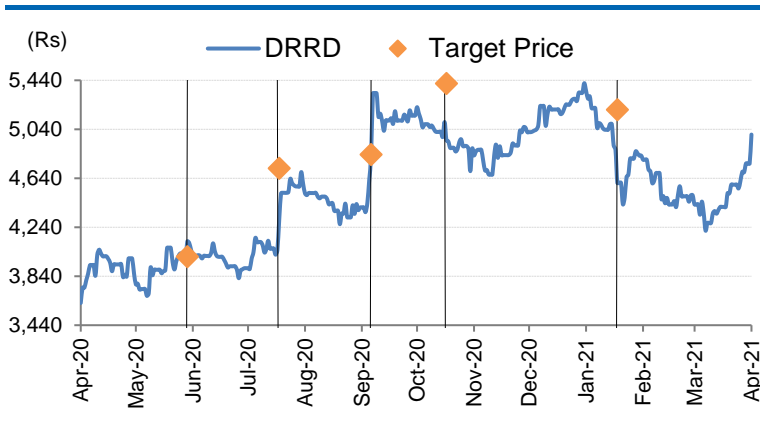
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jun-20	Accumulate	4,000	4,124
Jul-20	Accumulate	4,721	4,302
Sep-20	Accumulate	4,834	4,827
Oct-20	Accumulate	5,414	4,951
Jan-21	Buy	5,200	4,603

*Price as on recommendation date

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